



Consulting Assistance on Economic Reform II

Discussion Papers

The objectives of the Consulting Assistance on Economic Reform (CAER II) project are to contribute to broad-based and sustainable economic growth and to improve the policy reform content of USAID assistance activities that aim to strengthen markets in recipient countries. Services are provided by the Harvard Institute for International Development (HIID) and its subcontractors. It is funded by the U.S. Agency for International Development, Bureau for Global Programs, Field Support and Research, Center for Economic Growth and Agricultural Development, Office of Emerging Markets through Contracts PCE-C-00-95-00015-00 and PCE-Q-00-95-00016-00. This paper is funded by Contract PCE-C-00-95-00015-00, Task Order 39.

Modernization of Tax Administration in Low-Income Countries: The Case of Nepal

Glenn Jenkins
Rup Khadka



CAER II Discussion Paper 68
September 2000

The views and interpretations in these papers are those of the authors and should not be attributed to the Agency for International Development, the Harvard Institute for International Development, or CAER II subcontractors.

For information contact:

CAER II Project Office

Harvard Institute for International Development

14 Story Street

Cambridge, MA 02138 USA

Tel: (617) 495-9776; Fax: (617) 495-0527

Email: caer@hiid.harvard.edu

Modernization of Tax Administration in Low-Income Countries: The Case of Nepal

Glenn P. Jenkins and Rup Khadka

Glenn P. Jenkins is an Institute Fellow at the Harvard Institute for International Development (HIID) at Harvard University. **Rup Khadka**, a consultant for HIID, is the National Advisor at the VAT Project, Nepal. This paper draws from the sections on customs duties and income tax in the study “*Tax Reform in Nepal: A Comprehensive Review*,” Harvard University, Cambridge, MA, 1997. The authors wish to express their gratitude to Frank Flatters and James Owens.

Table of Contents

- I. Tax Administration Issues
 - A. Common Features of Tax Administration in Low-Income Countries
 - B. The Nepalese Situation
- II. Modernization of the Tax Administration
 - A. Unified Functional Organization
 - B. Human Resource Development
 - C. Modern Administrative Techniques
 - D. Computerization
 - E. Taxpayer Education Program
 - F. Self-Contained Tax Law
 - G. Effective Penal System
 - H. Efficient System of Appeals
- III. The Existing Structure versus the Revenue Authority
 - A. The Concept of the Revenue Authority
 - B. Rationale for the Revenue Authority
 - C. The Structure of the Revenue Authority
 - 1. Governing Body
 - 2. Scope of the Revenue Authority
 - D. Financing the Revenue Authority
 - E. Transition to the Revenue Authority
 - F. Experience with the Revenue Authority
- IV. Conclusion

ABSTRACT

Tax administrations in many low-income countries are weak, corrupt, and nontransparent. This inefficiency reflects both the mix of taxes and the faulty design in their structure and in their operational systems. The tax administration is also affected by policies relating to the salary, the attitude, and the reward and punishment system of personnel. The tax administration in low-income countries is driven by detailed revenue targets and not by the tax laws and accounting records. The tax officials are allowed both to earn money and still meet their revenue targets. Many things are done through negotiation rather than on the basis of information processing. Since the organized business sector provides the bulk of the tax revenue, it is the sector that is hindered by such a system. The development of the modern business sector and the globalization of business activities have generated pressure for tax administration reform.

A well-designed set of tax policies cannot be implemented properly by a weak tax administration. The Nepalese tax administration fails to deliver professional services. It has not been able to implement the tax laws and regulations properly, resulting in a huge gap between what the legal provisions say and their actual implementation. Although there has been considerable reform in the tax policies in recent years, dissatisfaction with the tax system has been increasing rather than decreasing. Knowing the limitations of the tax administration, many taxpayers try to take full advantage of the situation.

The tax administration in Nepal needs to be reformed drastically in order to translate tax theory into practice. For low-income countries tax administration is a central, not peripheral, issue for economic development. It must be modernized so it won't impede the growth of the progressive sectors in the economy. Administrative reform encompasses several areas relating to the organizational structure, the personnel system, the incentive package, tax procedures, penal provisions, and the appeal system. Several countries have created an independent revenue authority as a catalyst for the reform of the tax administration.

Tax Administration Issues

Common Features of Tax Administration in Low-Income Countries

In most low-income developing countries the tax administrations are often corrupt, inefficient, and do not operate in a transparent manner. This condition is the result of the mix of taxes used, their faulty design, and the methods of tax administration. These tax administrations are generally affected by policies relating to the traditional public sector personnel system, salary levels, and criteria for advancement or discipline that usually are rooted deeply in the country's history. In these countries the systems of tax administration follow a predictable pattern of behavior—but in a traditional way. Governments have been able to generate revenue by setting revenue targets for the tax administration while not being very concerned about how these targets are achieved. Tax officials cannot be blamed individually; any official joining tax administration will have to follow existing practice and procedures. Over time, the administrative system has become characterized by 1) a tax administration that works toward fulfilling revenue targets that are set well below the legal tax liabilities of the taxpayers, 2) low salaries for tax officials, and 3) the negotiation of tax payments between taxpayers and the tax administration. This has created a stable system in which government revenue targets are met, most taxpayers pay less than their legal tax liabilities, and tax officials make considerable income as a result of side payments, which arise from their negotiations with taxpayers. A great deal of uncertainty and administrative “congestion” are by-products of such a system.

The system of revenue targets drives the tax systems of low-income countries. Everything revolves around the annual target. From all indications, it is the primary and possibly only measure used by revenue departments to determine success or failure. The usual practice is to try to meet the revenue

targets without attempting to expand the tax base. Tax officials sometimes even put pressure on taxpayers to pay in advance in order to meet their revenue targets for the year. The belief among members of the business community is that if one tries to follow the rules, the end result is that one will be harassed and penalized, while those outside the system will continue to pay little or no tax. The first priority then becomes to avoid being caught up in the web of the tax system. This type of situation makes the informal sector relatively more attractive than the formal sector, leading to a smaller set of tax bases and to the growth of infamous “black economy” that, in the effort to avoid the tax system, has to evade all other business regulations as well.

In low-income countries, the salaries of tax officials, like those of other civil servants, are extremely low. These government workers are compensated through side payments, which they feel entitled to demand as a result of the authority that goes along with their positions. There are well-designed systems for the collection and distribution of the side payments by the tax administration. Tax officials usually have no interest in working in research or statistics units in the Ministry of Finance, where there are no opportunities for earning such side income.

In these countries, corruption is not limited to the tax administration. In the other branches of public administration, officials earn extra money on expenditure transactions. This is usually done by inflating the amounts of bills relating to office supplies and pocketing the difference, or by taking commissions from those wanting public contracts or licenses.

Such a tax administration does not meet the needs of a modern organized business sector that demands transparency and the rule of law. Most large businesses, even in poor countries, can maintain as advanced a system of accounts as that used by businesses in industrialized countries. These are the firms that pay most of the tax revenues to the government. With computerization and the fall in trade protection, these firms want to operate more efficiently in order to remain competitive. Therefore the business sector puts pressure on the government for the acceptance of its accounts by the tax administration. It wants to calculate its tax liabilities on the basis of actual rather than negotiated information. Negotiation, corruption, and revenue targets create the administrative congestion costs that

impede the development of those sectors of the economy that are trying to modernize.

In summary, low-income countries have tax administrations that have existed for a long time. The systems generally work and are not completely chaotic. They are, however, weak, corrupt, and inefficient, and they generate high compliance costs. There is great legislative power and discretion given to the tax administration that allows tax officials to earn money for side payments while achieving revenue targets. Everything is done through negotiation rather than on the basis of actual information. As a result, much of the revenue disappears. After paying bribes, the actual amount paid by the taxpayers to the government is quite low. The taxpayers gain and the tax officials gain, while the government loses and the tax system suffers. Such a system stifles progress. However, the great strides that are being made by the private sector in lowering the cost of information processing are creating pressure on the government to modernize the tax administration.

The Nepalese Situation

Until recently, Nepal collected all its major taxes, including customs duties, excises/countervailing duties, sales tax, and advance income tax at either the point of import or at the manufacturing stage. These taxes used to generate the bulk of the tax revenue. For example, more than 75 percent of the central government's total tax revenue was generated by these taxes in 1996/97. The octroi, which generated more than 80 percent of the total tax revenue of the municipalities, used to be collected at the municipal gates. Since all major taxes were collected at either the point of import or manufacturing, there was a tendency among the importers either to smuggle in order to evade tax or to declare lower values for their imports in order to reduce their tax liability. There was also a tendency for the manufacturers to create an artificial sales depot, sell it at the lower price, pay a low tax, inflate the selling price of the artificial sales depot, and then reap large profits. Dealers, wholesalers, and retailers were not required to register for any types of commodity taxes. While they were supposed to register for income tax, most of the traders had not been maintaining proper accounts for the purpose of this tax either. In response to this, a very nontransparent bureaucratic process was set up to administer all major taxes. This is explained below.

Until recently, in theory, at least, import duties were levied on the invoice price or the price in the customs valuation book, whichever was higher. The valuation book listed prices of goods commonly imported into Nepal. For most items, it was generally agreed that official values were low relative to true transaction values. For a few items, the valuation was deliberately set at an extremely low level, probably to make smuggling less attractive. And for a few other items, the valuation was set high in order to provide protection to local industry.

In practice, importers were to submit invoices indicating prices equivalent to values mentioned in the valuation book, irrespective of their real values, meaning that the import duties were levied on or around prices mentioned in the valuation book. This required the presentation of some false documents. For example, insurance documents and LCs (Letter of Credits) had to be provided for the amounts shown in the import documents. Shipments were generally underinsured, and the settlement of transactions had to be made, in part, through means other than LCs. The underinsurance of documents resulted in unintended costs and settlement through negotiation also imposed costs by requiring importers to go through the black market for foreign exchange (with a premium of about 10 percent) to settle the balance.

It is believed that administrative smuggling is rampant. To ensure the smooth processing of import shipments, there are more or less standard fees. Traders say that physical inspections and clearance delays can be kept to a minimum if customs inspectors are given “facilitation fees.” The structure of the fees is relatively well established. In order to facilitate administrative smuggling, there is a fairly well established system of sharing the gains between customs officials and importers.

Excise administration, which runs under a physical control system, is traditional as well. Under this system, a manufacturer of the excisable items is required to obtain a license and to renew it annually. He is required to provide an office and often housing to the excise inspectors posted at his factory. He has to obtain prior approval from the excise inspector in order to remove his products from the factory warehouse, pay the excise, and maintain the records of production, sales, stocks, excises, etc.

Before the introduction of the value added tax in mid-November 1997, manufacturers were also required to register for the sales tax, to renew their sales tax registration certificate annually, to get their prices approved and invoices certified by the tax officer, to get the signature of the tax officer on the voucher, to submit both monthly and annual returns, and to get their annual returns assessed by the tax officers. Some payers of the sales tax were also required to pay a hotel tax, entertainment tax, or contract tax. In those cases, the tax requirements increased considerably, since the taxpayers had to study four tax laws and their related regulations, and complete a number of requirements in order to comply with these taxes.

Since 'true prices' are not indicated on the import declaration form or on the selling invoices of manufacturers at the source, it has not been possible to declare true values on the invoices at the distribution level. It has been difficult, as well, to maintain proper accounts for tax purposes. Consequently, although traders are asked to maintain accounts for income tax purposes, they do not. Income tax is also assessed largely according to the 'best judgment' of the tax officials, although different methods of tax assessment exist for different types of taxpayers. For example, some taxpayers are assessed under the official assessment system, with their income evaluated either on the basis of their own accounts or on the basis of the best judgment of the tax officer, while some taxpayers are assessed under a self-assessment system. A committee assesses some taxpayers, while others are subject to a presumptive tax. As there is a scarcity of reliable account data for the conducting of business, the tax administration tries to apply one arbitrary tax rule or another in order to assess the income of different types of taxpayers. Under all the various methods, the tax assessment is done arbitrarily, leading to unfairness in the way different taxpayers are treated.

In practice, tax officers assess the bulk of taxes. During the assessment process, it is a common and accepted practice for officers to negotiate with the taxpayers. There is a lack of trust between the two parties. Taxpayers say that their books and accounts are disregarded. On the other hand, tax officials say that taxpayers maintain false accounts for tax purposes, grossly understate their income, and submit false returns. The general practice is to apply presumptive profit rates to turnover, irrespective of actual income. This encourages the understating of turnover. Peak year income also does not get

reported in order to prevent raising the base profit rate. The negotiation takes place at the lower levels of the tax administration, with taxpayers paying commissions to the tax officials. During this process, the tax official and the taxpayer win, while the government and the tax system lose.

The local tax administration is inefficient as well. For example, the octroi was the major source of revenue for municipalities, often generating more than 80 percent of the total tax revenue. This tax was levied on goods brought into a given local area for commercial, professional, or industrial use in commercial quantities. This tax was also paid in the form of a deposit on goods in transit through a municipality, often resulting in payment of the same deposit several times when goods were transported through the jurisdictions of many municipalities. This deposit was theoretically refunded when goods were taken out of the jurisdiction of the given municipality.

Vehicles were stopped at several points for the purpose of collecting the octroi. This created not only inconvenience for the importers and passengers, but wasted time and energy and increased the costs of production and trade. As the free flow of traffic and trade was hindered, it interfered with the growth of trade and industry. The octroi was collected by contractors who did not follow the rules and levied the tax haphazardly. For example, although according to the law any tax paid as a deposit at the entry point was to be refunded at the exit point, in practice, obtaining a refund from contractors could be quite difficult. In some cases, the tax paid as a deposit was refunded only when the importers submitted proof that their goods had reached their destination within a specified time.

This tax system and these procedures actively and strongly discourage the development of an account-based transparent tax system. Inconsistency and lack of transparency in the tax procedures have had various implications for revenue, fairness, and efficiency of resource allocation. They have also undermined confidence in and respect for the government's fiscal apparatus. The bargaining system, together with an inadequate legal framework related to taxpayers' rights and personnel compensation, and the lack of an effective appeal system, have caused considerable uncertainty and imposed unnecessary and unforeseen costs on taxpayers. They have impeded the development of the modern private sector that pays the most of the tax revenue.

There is an urgent need to switch from this system to one based on law and information. For this, it is necessary to develop an account-based tax system. The process has already started with the introduction of the value added tax on November 16, 1997. This tax is designed to reduce opportunities for corruption. Under the value added tax system, individuals must record each transaction and submit a monthly tax return. It is difficult to negotiate the tax liability on a monthly basis. Since the value added tax has brought importers, manufacturers, dealers, wholesalers, and retailers into the tax net, they are required to maintain proper accounts of their transactions. It is quite difficult for them to do so as long as the 'book valuation' for customs purposes and 'best judgement assessment' for income tax purpose continues. For example, if the 'book value' for customs purposes is fixed at Rs 50 for a commodity that is imported at Rs 100, the importer pays tax on Rs 50. He is forced to indicate Rs 50 as the purchase price in his purchase book. If his value added is Rs 20, his selling price would be Rs 120. If he issues the selling invoice for Rs 120, his recorded value added would be Rs 70 instead of Rs 20. In this case, he would have to pay an unnecessarily high income tax. To avoid this, he would either not issue an invoice at all, or he would issue an invoice for a little above Rs 50 (Rs 55 or Rs 60, for example), even if he charges Rs 120 to the dealer. The dealer would not be in a position to issue a proper invoice for the same reason, and he would charge Rs 140, but issue an invoice of Rs 60 or Rs 65. This would happen at the wholesale and retail levels as well.

The value added tax system cannot run under such a scenario. This system demands transparency in other taxes as well as in tax administration. So it has become necessary to reform the customs and income tax systems as well. With this in mind, the government has announced a policy of accepting the invoice value for customs purposes. The customs administrators are hesitating to adopt the new system, since they lack reference price lists to determine whether the value of the consignment is reasonable. Besides, the valuation system is attractive to customs officials, since it gives them the authority to fix the values of imported goods and provides opportunities for collusion and corruption.

Changes have also been introduced into the field of income tax, so that the accounts maintained for the value added tax will be accepted for income tax purposes. Taxpayers, however, do not believe that the tax officials will accept their accounts at face value for the purposes of income tax. Tax officials

are also not enthusiastic about implementing the new system.

While in theory Nepal has begun the process of transition from its traditional tax administration to a more modern one, that process is, needless to say, by no means complete yet. Attempts to change the traditional tax administration have faced considerable resistance from various parties. It will be necessary to adopt a series of reform measures in order to fully modernize the tax administration.

Modernization of the Tax Administration

In the case of low-income developing countries, the respective tax administrations must be reformed drastically in order to translate tax theory into practice. Reform of the tax administrations, in turn, will provide greater choices to the policymakers in designing tax policies. While an appropriate mix of taxes, rationalization of their structure, and the simplification of tax procedures all have a great bearing on the modernization of tax administration of any country, it is also crucial to bring a series of reforms into the organizational structure, the personnel system, the incentive package, the penal provisions, and the appeal system. Similarly, it is necessary to implement computerization in order to establish an information-based tax system. The following measures are recommended for the modernization of a tax administration of a low-income developing country such as Nepal:

- Unified functional organization
- Human resource development
- Modern administrative techniques
- Computerization
- Taxpayer education program
- Self-contained tax law
- Effective penal system

- Efficient system of appeals

Unified Functional Organization

Tax administration can be structured by type of tax or by function of tax administration. In many low-income developing countries, the tax departments are structured along traditional lines by type of tax. For example, in Nepal, the Tax Department, Customs Department, Value Added Tax Department, and Land Revenue Department have been created as independent departments. Tax offices are established and sections and subsections are created on the basis of geographical areas. Under this system, a tax officer is made responsible for the administration of each and every aspect, including the registration, assessment, and collection of a specific tax in a particular area.

Such an organizational structure based on tax type and geographical area has both advantages and disadvantages. Since a tax officer deals with all the taxpayers of an area, he has a good knowledge of the taxpayers. Since he is not a specialist, it is easy to find a substitute for him when he is on leave or when he leaves the job or is transferred elsewhere. There is also clear accountability and control of each tax.

However, it takes a long time and considerable investment to train a tax officer on all aspects of taxes. It is not possible to create a specialist. Since there is not much opportunity for checks and balances, this system provides many opportunities for collusion between a taxpayer and tax officer and is defective and corruption-prone. Since there is duplication of works with such an organizational structure, it is also expensive for both the tax administration and the taxpayers. For example, in Nepal, various tax offices exist in each major urban area to administer different taxes. Most of these offices, however, deal with only a small number of taxpayers and generate nominal amounts of revenue. In the Land Revenue offices, the total amount of administrative expenditures incurred by the thirteen offices in 1994/95 was more than the amount they collected in revenue for that year. The taxpayers had to visit many different tax offices in connection with various taxes, yielding high compliance costs. The physical facilities of the tax administration in this system also are not conducive to a good working environment.

It is also difficult to adopt a single taxpayer identification number (TPIN) when several independent departments are created to run various taxes. For example, in Nepal, the Tax Department and the Value Added Tax Department currently issue separate TPINs to the taxpayers. It has become difficult to unify these numbers. The Value Added Tax Department claims that the TPIN with a check digit, which the Value Added Tax Department developed, is more scientific. On the other hand, the Income Tax Department claims that the TPIN provided for income tax purposes should be adopted, since the number of income tax payers would be many times greater than the number of value added taxpayers.

Under such an organizational structure, it also becomes difficult to establish and maintain a common registration database for all types of taxes or a taxpayers master file. This is because each department will continue to modify its own database.

It is therefore necessary to amalgamate different tax organizations into a single unit, which would help reduce both administrative and compliance costs. It has been commonplace in the international arena to establish a single unit to collect various taxes. For example, the Netherlands used to have different tax offices for the administration of various taxes. Since such a practice yielded multiple relationships between taxpayers and tax officials, the Dutch government, between 1989 and 1992, unified the tax offices and now each tax office administers all the types of taxes. South Korea adopted a functional type of unified tax administration known as the National Tax Service in September 1999. Similar attempts have been made in Canada to integrate the administration of all taxes levied by the different tiers of government.

Such a system is necessary in low-income developing countries, which are far behind with respect to economic resources and skilled manpower. The amalgamation of different revenue units into one single unit would make it possible to equip tax offices properly with the same resources and enable them to collect revenues at a lower overall cost. It also avoids duplication of work and improves coordination. It allows for a single unit to be set up for the tax audit. Tax officials would have to deal with each taxpayer once only for various taxes, thereby saving everyone's time. Under this system,

taxpayers receive better service and face lower compliance costs. It would also make it feasible to adopt a single taxpayer identification number, a taxpayers master file, and common database that is capable of identifying the taxpayer in connection with each tax. With such a system, the tax administration would know the different taxes a particular taxpayer has to pay, the payments he has or has not made, and the fines or arrears, if any, on his account. It enables the tax administration to keep an effective control over the taxpayers and relieves taxpayers from the formalities of obtaining various tax numbers from different tax offices.

The unified organization should be structured on the basis of function. For example, different sections or subsections should exist for registration, collection, assessment, audit, refund, and taxpayer service. Under the functional structure, a tax officer is made responsible to handle a specific job—for example, registration or collection or refund or audit. In this way, it is possible to employ a tax officer according to his interests and to develop specialists in the tax administration who can work efficiently in their respective areas. Under this system, there is less opportunity for collusion and corruption.

It is therefore necessary to unify various independent tax organizations into one central unit and to develop this unified organization along functional lines. The duties of each unit and the job description of each position in this organization must be clearly spelled out. Such a move leads to greater efficiency and lower expenses in low-income countries.

Since the bulk of the tax revenue comes from a few large taxpayers the tax administration should establish and develop a division in order to treat them in the way that suits their nature and needs. Such a division has been created in many tax administrations, including low-income countries such as Nepal and Bolivia, and is under preparation in Thailand and in the Philippines. Such a unit was made part of the collection division in Uruguay to control filing and payment of the country's large taxpayers.¹

Human Resource Development

Another issue is related to the overall problem of personnel development. In some countries, a specialized group is created for administering taxes with special rules relating to recruitment, transfer,

training, promotion, salary, and so on, while others still consider tax administration a general service and do not separate it from the other branches of general administration. In many low-income countries, the tax administration has been part of the general government service. As a result, trained officers often get reassigned to other positions where their tax skills are no longer useful.

In Nepal, a revenue group was created within the Nepal administrative service in order to run the tax administration. While certain criteria are fixed for entry into the revenue group, hiring, transferring, and promoting practices are similar to other fields of public administration. Postings are very discretionary and are guided more by the personal interests of the officials than the interests and requirements of the revenue administration. For example, those officials who have connections with powerful politicians or any other influential people are posted either in the customs or income tax offices where there are more opportunities to earn private money. Others are posted in the value added tax administration or the Revenue Administration Training Centre, where there is little opportunity to make extra money. In these places, staff turnover is very high. This situation is not unique to Nepal; it happens in many other low-income developing countries. For example, in Bolivia, more than 70 percent of the tax officials are replaced with a change in the government.² It is just not possible to expect a professional tax administration under such a system.

In low-income countries, the training of tax officials has not been given adequate importance. Tax training is not well institutionalized. Domestically organized tax training is not attractive for the tax officials. However, they are more attracted to overseas training, which they view as an opportunity to visit a foreign country and save some money rather than as an opportunity to learn. Nepal is not an exception. The country's tax officials are not given specialized training on taxation. The new entrants to the tax administration are directly posted to field offices without being given any basic training for their jobs. No arrangements are made to initiate any long-term training program to acquaint the trainees with various aspects related to tax administration. The longest duration of the training, if any, is five weeks and for that, too, it is not easy to get sufficient number of trainees, since revenue departments do not want to spare their officials for such a long time. While the tax officials try their best to be nominated for the overseas training, those who are nominated often take such an opportunity as a pleasure trip to a

foreign country.

In Nepal, the tax officers themselves are not well briefed on tax acts and regulations, and are not willing to give opinions in writing to clarify the interpretation of the law in order to make it easier for the taxpayers to comply with it. Most of the tax officials lack an understanding of business or accounting. Interpretations of the law are inconsistent and individualistic.

In low-income developing countries, tax officials, like other officials working in other branches of administration, are paid very low salaries, often below minimum wage. The tax officials cannot be devoted to their work with such low salaries, and they look for other sources of income. The system of informal payments has become institutionalized in order for offices in the tax administration to be able to survive financially.

In low-income countries, an orientation to service the customer hardly exists among tax officials. Rather than providing prompt service to the taxpayers, tax officials harass them in different ways. In Nepal, the tax service used to be considered a noble profession, but now has a very low image in the eyes of the public. If this trend continues, the tax administration may no longer be an attractive place for talented and hard-working people to work.

This indicates the need to:

- Create a specialized tax service in order to motivate tax officials for the development of a career in tax administration
- Provide tax officials with both theoretical and practical training in various aspects of tax laws and regulations
- Increase salaries
- Change the attitude of the tax officials so as to make them more service-minded.

- Develop a personnel management system with which the evaluation of tax officials is done on the basis of their overall work performance—an evaluation that would include such things as a judgement on the efficient utilization of time; technical competence in the law, accounting, auditing, and collection techniques; the ability to identify significant issues during the audit and investigation process; and the ability to meet and deal with people.

While these moves are certainly desirable in order to reform the tax administration in low-income countries, it is not easy to implement them. These issues are perhaps the most difficult areas to handle in the process of reform of the tax administration. As Jantscher and Bird observe, “it is usually difficult, and often impossible, for tax departments to obtain more staff, to raise wages to attract (and retain) highly qualified staff, or even to meet such basic material needs as office space and computers.”³

While these countries cannot afford to change the whole public administration at one time, it is necessary to begin the process somewhere, and tax administration is the natural place to start the reform process. Some countries such as Bolivia introduced a salary bonus program for tax officials during the 1987/88 tax reform. Under this system, officials were supposed to get a certain percentage of the difference between the actual tax collection and tax targets. A similar system was introduced in 1992, when the difference between the actual collection and target was distributed as follows:⁴

- Sixty percent was deposited to the treasury.
- Thirty percent was allocated to the tax stimulation fund to be distributed to the tax personnel on the basis of their work performance.
- Ten percent was allocated for infrastructure and equipment.

This system, however, did not last long. In some countries, attempts were made to add to the tax officials’ regular salaries through external sources, such as the UNDP (United Nations Development Program) fund in Bolivia and the USAID fund in Nepal for the members of the Value Added Tax (VAT) taskforce. These are, however, not long-term solutions.

Modern Administrative Techniques

In low-income countries, tax administrations use traditional techniques and procedures, which are far from desirable. Tax administrators are guided by the traditional excise tax mentality. They do not want to make any effort to gather information about the citizens' taxable activities and do not make any extensive audit or investigation. They would rather ask the taxpayers to provide required information to the tax office. They adopt the physical control system or adopt traditional procedures under which taxpayers are required to receive approval from the tax authorities of their prices, certification of invoices, annual renewal of tax certificates and other registrations, including business registrations. Such measures are costly and are not compatible with a modern tax administration.

For example, in Nepal the annual renewal of registration for income tax and excises is administratively inefficient. It is also abused. Several inquiries need to be made before the renewal of registration is given. Clearance of taxes is required before the registration certificate is renewed, or a deposit of estimated taxes is made. Renewal of the registration certificate is required for a motor vehicle license as well as for a letter of credit for imports and exports. This means that if a certificate is withheld, a firm can be put out of business. A refusal of registration frequently results in businesses either changing their identity from time to time to hide their tax-paying history, or doing some or all of their business underground.

In low-income developing countries including Nepal, tax forms are unnecessarily complicated and redundant. Taxpayers have to submit several pieces of paper, which are hardly used by tax officials for any purpose. This only increases the compliance cost for taxpayers. There is excessive use of internal departmental circulars to give rulings on tax issues. These internal circulars are not made public. Despite the fact that several changes are introduced annually in the system through the Finance Act, the guidelines, instructions, and notices do not necessarily keep up with them.

In many cases, even the tax forms are not easily available. Taxpayers have to bribe tax officials to get the forms. Tax officials do not assist taxpayers in completing the forms unless they are paid to do

so by the taxpayers. This gives the wrong signal to the taxpayers and discourages tax compliance.

Administrative procedures must be simple and transparent. Taxpayers should not be discouraged from paying taxes by overly complicated or confusing tax procedures. Forms and procedures must be kept simple in order to keep costs low. Taxpayers must be asked to submit only that information and those documents that are likely to be useful and that are unavailable otherwise. In the case of income tax, those taxpayers whose income consists solely of salaries/wages subject to withholding plus interest on a bank account should not be required to file a return. The withheld tax should be treated as a final tax. This will not only relieve lower- income earners from the burden of filing returns, but will also allow tax officials to concentrate on the larger taxpayers.

It is also necessary to develop an efficient system of audit and investigation that is essential for running a modern tax administration and is based on the principle of self-assessment. It is, however, difficult to find and keep professional auditors in tax administration in low-income developing countries. Even if they are trained, they do not follow the appropriate auditing procedures because of the fear of losing their private money. In Nepal, for example, despite the fact that tax auditors have been trained more than once in accounting and auditing methods, in actual practice they still work according to the old traditional methods.

Simplification of the tax procedures should perhaps be the easiest thing to do as part of the reform of the tax administration in a low-income developing country like Nepal. It does not cost money, it reduces both administrative and compliance costs, it minimizes opportunities for corruption, and it enhances compliance. Low-income developing countries must therefore be vigilant in keeping tax procedures as simple as possible.

Computerization

In many low-income countries, tax administrations are not computerized. In Nepal, for example, many tax offices do not have computers, and those that have computers do not use them properly. Most work is done manually, causing delays and mistakes. When the number of taxpayers is large, it is

difficult to do all the work manually. The fall in the price of computers has opened up many new possibilities for using information technology in tax administration.

In the process of modernizing the tax administration, the tax offices must be computerized. This will prove to be useful in speeding up the day-to-day work and in making the compilation of data easier. With the same database, each function of tax administration can be handled more efficiently. In view of the limited financial resources available and the lack of trained manpower and of other facilities in poor countries, computerization may have to be phased in gradually. It will often be more practical to concentrate most of the computer work initially in the city center and have the districts later utilize the data produced. The computer system can be gradually extended to all the offices later, as more people are trained and the citizenry gets used to the system. Computers should be installed first in selected major revenue offices. This would cover most transactions. For example, in Nepal, more than 80 percent of total imports pass through four customs points, and four tax offices collect about 80 percent of total income tax revenue. Similar situations exist in the case of other taxes.

This approach was adopted by the value added tax administration in Nepal, which has developed a comprehensive computerization system. The Value Added Tax Department was computerized first. A local area network (LAN) was established in the department. Several modules such as registration, returns, payments, refunds, computerized accounting systems, computer generated assessments for taxpayers who failed to file tax returns, and computer selection of taxpayers for verification and audit were developed, tested, and implemented.

Under the centralized data processing system, documents such as the application for value added tax registration, value added tax returns, payment vouchers etc., are received first by the value added tax offices and batched to the Value Added Tax Department. Data entry and processing is done at the computer section in the Value Added Tax Department, and necessary printouts are sent to the value added tax offices. The computer system provides such output as registration certificates, a registrants' list, a nonfilers list, posting reports, outstanding reports, audit trial reports, refund claims, and revenue reports. These are generated by the taxpayers and the Value Added Tax Office.

After personnel in the central offices had gained some experience, value added tax offices were computerized. Under the decentralized system, value added tax offices enter data themselves and transmit the data to the Department, which in turn validates the batches transmitted by the value added tax offices before posting the information into taxpayers' accounts and transmitting the output back to the value added tax offices. Other branches of tax administration should be similarly computerized.

It is equally important to computerize tax administration in other low-income countries as well since the automation of the tax administration facilitates its day-to-day administration and reduces the opportunities for political intervention, collusion, and corruption. Computerization also generates information in a more systematic and transparent way and reduces the potential amount of negotiation between tax officials and taxpayers. Computer technology is currently relatively inexpensive. There is a strong case to be made for the computerization of tax administration in the low-income countries, but it should be done in a gradual manner. In these countries, management often does not have enough experience with computerization to know what it can and cannot do for them. There is resistance from those who get undue advantages under the existing traditional tax system. It is difficult to find and retain computer experts in public administration. For example, recently in Nepal, a computer engineer was trained in the value added tax (VAT) application and then took a job in a firm in the United States, while another one, also trained in VAT application, joined a local private firm. This has happened elsewhere also. For example, in Bolivia several computer personnel left the tax administration after being trained by the UNDP project.⁵ In Nepal, a private firm has been hired to develop the computer system and, to date, the system is functioning well. This firm, however, has been financed by the Value Added Tax Project, which is funded by external sources. It is uncertain whether the government will be able to hire this firm after the termination of the VAT Project. The government intended to outsource some of the maintenance aspects of the computer system. But the outsourcing has not been done yet due to the lack of a minimum number of bidders required by government procurement rules. The dilemma here is how to make computerization sustainable. An appropriate strategy has to be adopted from the outset of the process.

Taxpayer Education Program

One of the important functions of the modern tax administration is to raise the level of voluntary tax compliance. In order to encourage this, the tax administration needs to carry out an extensive taxpayer education program. Such a program may include such activities as the preparation and distribution of tax brochures, pamphlets, posters, the conducting of dialogue sessions, tax interaction programs, seminars, preparation of television and radio programs, and publication of newspaper articles and advertisements. These programs should focus on the rationale for the various taxes and explain their structure and operation. Taxpayers should be reminded of deadlines.

The tax administration must publish all the legal interpretations and major changes in acts, regulations, and procedures. The preparation and distribution of tax tables and manuals with practical examples would enhance voluntary compliance.

In Nepal, there is a serious lack of tax information among the general population. Neither the Tax Department nor the Ministry of Finance has published any brochures, booklets, or similar documents in order to educate the populace. Taxpayers have not been made aware of their responsibilities and their rights. The Value Added Tax Department, however, has launched an extensive taxpayer education program, which involves brochures, newspaper articles, and radio and TV programs, to educate potential taxpayers before the tax is introduced. The objective of this program was to dispel some of the fears about the value added tax among the business community and to give them and others some idea of the structure and operation of the value added tax. The program focused on obtaining input from the business community for the refinement of the drafted value added tax law. At a later stage, it attempted to educate consumers and others, including parliamentarians and journalists, on different aspects of the value added tax. The tax administration needs to launch and sustain a comprehensive taxpayer education campaign covering all the major taxes in order to raise tax awareness and enhance tax compliance.

In Nepal, the taxpayer education program under the VAT system was launched through the foreign-funded VAT Project. The government does not allocate much money for this type of work. It

must realize, however, that an investment made in taxpayers' education programs would be productive and might give even more immediate results than an investment in tax officers' training. There is a tendency among tax officials not to change their traditional working style even after the training, due to a fear of losing private facilitation money. Some tax administrations have taken these facts into account and made huge investments in taxpayer education programs. For example, in 1987/88, the Bolivian government decided to spend about 10 percent of the annual budget of the Ministry of Tax Collection on taxpayers' education programs.⁶ Taxpayers' education and services have also been given high importance by the Internal Revenue Authority of Singapore. Since taxpayers' education programs enhance taxpayers' compliance, they should be given priority by the tax administrations in low-income countries.

Self-Contained Tax Law

In many low-income countries, tax laws have become unnecessarily complex. They are embodied in numerous pieces of legislation, which increases uncertainty about the detail of the current law that is applicable. For example, in Nepal, the Income Tax Act, the Industrial Enterprise Act, the Co-operative Act, the Electricity Authority Act, and the Finance Act all affect the income tax system. Annual changes in the tax system are effected through the Finance Act. However, these changes are not incorporated into the related tax laws, leading to discrepancies among the provisions of the Finance Act and the related tax laws. Tax procedures are introduced every now and then through departmental circulars. The circulars are not made public, so taxpayers have no way of knowing if tax officers are operating on their own or following internal instructions.

Tax-related provisions should be included in the concerned tax law only. The Finance Act should amend the concerned tax law, rather than standing on its own. No other act should have an effect on tax. These changes should not be costly to implement. If politicians and other officials stand firm, it should be possible to do this even in the low-income developing countries. The use of the internal circulars should be kept to a minimum, while the procedures introduced through circulars should be made public.

Effective Penal System

Simple and transparent tax provisions enhance compliance with the law, while consistently applied penal provisions discourage noncompliance. Therefore, along with simple and transparent provisions, uniformly enforced penal provisions also form the basis of the modern tax administration. In the absence of such provisions, a modern tax system based on self-assessment will not work properly. Strong penal provisions need to be in effect for those who do not register for taxes, do not file returns and do not pay taxes, and these measures must be implemented effectively when needed.

In Nepal, in general, penalties for the evasion of tax responsibility are inadequate and inconsistent. For example, the established penalty fixed for the failure to register and deduct and credit withholding tax (in the case of income tax) is only Rs 500 (US \$7). In the case of self-assessment of income tax, fines for mistakes and fraudulent reporting are fixed at the same level. Several penal provisions have been fixed many years ago and not been changed for a long time. Consequently, their effect has been eroded very much due to inflation. Even these penal provisions are hardly used in practice.

Nepal is not unique in this respect. Other low-income countries also generally do not make use of their penal provisions. For example, the new provision in Bolivia's tax code, which allowed for criminal prosecution of tax evasion, was not implemented at all during the 1987/88 tax reform period.⁷

In the context of the introduction of the self-assessment system in the income tax and value added tax, it is necessary to establish an effective penal system in order to discourage noncompliance. The penal system should not be made discretionary, since this would give opportunities for collusion and corruption, and be difficult to apply due to political pressure and other factors. It is, therefore, desirable to specify penalties for specific offenses. Automatic calculation of interest, charges, or penalties by computer is the best way to implement penal provisions uniformly. Penalties must be levied consistently. For example, a fine of Rs 20 imposed each time a parking rule is broken may be more effective than a fine of Rs 1000 or even imprisonment, if it is rarely imposed.

Efficient System of Appeals

It is necessary to establish an appeal system that is independent and impartial. At the same time, there must be specific rules and time requirements in order to maintain revenue levels. The appeals system should be structured to balance a number of interests. The system should be able to deal rapidly with minor technical problems in tax assessments. At the same time, both the taxpayers and the tax administration should be required to use documents whenever possible to substantiate cases. Taxpayers must be able to produce books and records, while tax administrators should have to give reasons in writing regarding the laws, regulations, and rules for their assessments.

In Nepal, taxpayers can currently choose to file an appeal to the Director General or to the Revenue Tribunal in the case of income tax. Undisputed portions of the tax need to be deposited in either case. In addition, in the case of an appeal to the Director General, one-third of the disputed amount must be deposited. The corresponding figure is 50 percent in the case of an appeal to the Revenue Tribunal. If the assessee loses, a fee at the rate of 25 percent per annum of the tax due is charged. This can be very onerous if the appeal takes too long to be decided, which is generally the case. An appeal to the Director General is likely to be biased in favor of the tax officials. Tax department officials are both prosecutors and judges.

Under the value added tax system, a taxpayer may file an appeal to the Revenue Tribunal within thirty-five days against a tax assessment or a penalty order by a tax officer or an order by the Director General relating to the suspension of his place of transaction. Before filing an appeal, the taxpayer must deposit the disputed amount of the assessed tax due and the rest of the amount of the tax plus the whole amount of the fine, or else he must insure guarantee of the same.

In Nepal, the appeal system is weak and inefficient. It takes many years to settle audit cases. As a result, those who go for appeal to postpone tax payment gain, while those who go for an appeal for legitimate reasons tend to suffer.

The appeals system should have at least two levels of appeal apart from and independent of the

Tax Department. The first should be a low-level court or tribunal, which should handle more straightforward technical matters concerning disputed assessments or reassessments, while the second should be a high-level court, to deal with cases of disputed legal interpretation.

Persons outside of the government and independent of the Tax Department should staff the Revenue Tribunal. The chairman should be a lawyer familiar with legal procedure, while the other members should be drawn from the accounting and business fields. The relevant associations could be used to nominate panels of potential members to be appointed by the government. The appeal must be based on the production of appropriate books and records (preceded by the settlement of undisputed taxes and the deposit of one-third of the disputed taxes).

Findings of the tribunal should be final unless appealed to the Supreme Court by the Tax Department or taxpayers within ninety days. The hearing of a Supreme Court case must be preceded by the settlement of all undisputed tax assessments and the deposit of 50 percent of any taxes in dispute. Findings should be recorded and reasons given based on tax acts and regulations, and must be available to the public for scrutiny.

The Existing Structure versus the Revenue Authority

The challenge is to bring about fundamental reform in the tax administration of a low-income country that finds itself in the above situation. There are basically two options. One is to strengthen the existing tax administration as a government department, and the other is to create a new autonomous revenue authority. Some countries have brought about reform in their existing tax administration, retaining it as a part of the civil service, while others have created an autonomous revenue authority in order to bring about faster reform. Experience elsewhere indicates that reforming the tax administration within its existing departmental setting is time-consuming, costly, and uncertain. This process, at best, can be seen in the difficulties that arise when attempting to achieve budgetary and employment flexibility through the reform of civil service procedures. For example, in Nepal, under the existing civil service

rules, there is no flexibility in establishing conditions of service to attract and retain competent staff. It is also very difficult to dismiss corrupt staff. Delays in the creation of a position are excessive. In the Value Added Tax Department, for example, technical positions could not be created. Hindrances and obstacles such as these stand in the way of reform. Several outdated civil service rules have tied the hands of policymakers in regard to the recruitment, transfer, and promotion of good people.⁸

The creation of a functional organization and the training of tax officials may not be that effective if the attitudes of the tax officials cannot be changed. This has happened in Nepal under the VAT administration, which was created along functional lines and where many general as well as specialized training programs were organized for the tax officials. These officials, however, have been reluctant to apply their knowledge in practice due to a lack of incentives. It has also proven difficult to attract and retain good people in the field of computerization in public service.

Since modern tax administration demands highly qualified tax officials with a detailed knowledge of accounting, auditing, law, and economics, and well-trained computer personnel, it is necessary to create an appropriate working environment that should include, among other things, higher salaries, so that competent professionals can be attracted and retained in tax administration. But it is not easy within the civil service to make such arrangements only for a specific line of administration. In Nepal, while the need to provide some incentives to the VAT administration has been recognized, civil service rules have not made incentive possible.. It is, therefore, very difficult to bring about changes in the tax administration whenever questions of human resource development and budgets are involved.

A quick and effective way to create an efficient and effective tax administration is to separate the tax administration from the general civil service and create an autonomous revenue authority, vested with administrative independence but under the control of the Ministry of Finance. If a high degree of voluntary compliance is to be achieved, the tax administration must be able to interact with taxpayers using modern technology and skills. If the tax administration lags behind, higher compliance costs for the taxpayers and a lower level of voluntary compliance will result. If the tax authority is to be able to provide effective taxpayer service, it must be able to operate as efficiently as the private sector. To keep

up with the rest of the economy, the tax administration must be able to apply the same level of skills and the same types of technology as the business sector uses and to serve its customers in every strata of society. A tax administration that is responsive to the private sector could perhaps be developed faster through the creation of an autonomous organization rather than through reform of the traditional civil service. A new revenue authority would require, as a key feature, flexibility for the Minister of Finance to establish appropriate conditions of service and to allocate financial resources to cost-effective tax collection strategies.

The Concept of the Revenue Authority

If the tax administration is to be separated from the general civil service, it needs to be placed under an independent statutory revenue authority. The revenue authority can work as an autonomous organization just like the central bank, which implements monetary policy. The central bank also assists the government in formulating monetary policy. The officials of the revenue authority should develop tax policy proposals. In addition, as the revenue authority serves as the provider of information needed for the formulation of tax proposals, it is important that the Ministry of Finance work closely with the revenue authority. The revenue authority itself should implement tax policy.

It has been shown fairly conclusively that a revenue authority serves a nation better if the responsibility for determining fiscal policy is separated from its application. Although the authority exercises its skill best in the application of policy, it also provides the essential feedback necessary for policymakers both before and after policy changes are implemented.

Rationale for the Revenue Authority

The availability and retention of trained human resources are by far the most important factors in determining the efficiency of the tax administration. The environment within which human beings are placed has a significant influence upon them. It is therefore necessary to create a suitable environment for the development of an honest, creative, efficient, professional, and service-oriented tax administration. The establishment of an autonomous revenue authority could be an important step in this

direction. The revenue authority should have the power to hire, fire, reward, and motivate its staff. The authority also should have autonomy in spending its budget according to the needs of the tax administration.

An autonomous revenue authority should be able to respond quickly to market conditions. It would have greater flexibility in establishing conditions of service in order to retain existing competent staff and attract promising new staff. It should also have the authority to dismiss dishonest staff more easily than the civil service can.

The Structure of the Revenue Authority

Governing Body

A governing body should oversee the revenue authority. There are different practices around the world regarding the composition and appointment of the governing body. Kenya, Malaysia⁹ and Uganda,¹⁰ for example, permit the Minister of Finance to appoint between two and four members to the Board who are experienced in financial, commercial, tax, or legal matters, and four to five members who are designated government officers. In Zambia, in addition to appointing board members representing designated public sector officers, the Minister of Finance formally approves, for a three-year term, one nominee each from the Confederation of Chambers of Commerce and Industry, the Institute of Certified Chartered Accountants, and the Bankers Association. He also formally approves a representative of the Law Association of Zambia and appoints two other members. The Governing Board elects the Chairman and Vice Chairman¹¹ from among its members. In Singapore, the Finance Minister is the Chairman of the Board, which has four to six members chosen by the Finance Minister on an irregular basis.¹²

Although opening the board membership up to include the private sector may attract a broader talent pool, yield an approach that is more oriented toward customer service, control costs, and check potential corruption by government insiders, it has substantial drawbacks. Most troubling among these is the potential for conflict of interest and breaching of taxpayer confidentiality. Stricter selection

procedures and standards, asset and background disclosure provisions, confidentiality rules, and conflict of interest guidelines may be included in the legislation as a remedy to these problems. However, where it is likely that such provisions will neither be adhered to nor strongly enforced, these problems might eventually destroy the credibility of the tax administration.

At the same time, in countries where there is a strong tradition of political patronage, a semi-autonomous revenue authority might make the problem worse. In such a case, placing the revenue authority further away from the span of control of direct political influence has been preferable in some instances. This is not unlike the experience of central banks which attempt to operate without political interference.

The revenue authority should be managed as a professional organization, as it administers the tax laws. There should be no intervention by the governing body in the day-to-day activities of the authority. No individual member of the governing body should be permitted to make inquiries into the activities of the revenue authority or to make any decisions without the formal approval of the governing body. It is also extremely important that the governing body not have the authority to intervene in any ongoing tax cases. The overall authority to administer the laws as they relate to specific tax cases must rest with the head of the revenue authority. These conditions should be explicitly stated in the law. In practice, of course, the behavior of members of the governing body is not likely to be so easy to control. It will have to be monitored continuously, with improvement occurring over time.

Similarly, experience elsewhere indicates that the power given to the Finance Minister to appoint a few members of the board has not produced good results and is not likely to be beneficial for other low-income developing countries, including Nepal.

Membership in the governing body should be limited for several reasons. First, a large governing body makes it difficult to schedule meetings and come to a consensus. Secondly, the larger the governing body, the more difficult it becomes to find and remove individuals who are perceived to have a conflict of interest. Third, the larger the governing body membership, the less individual accountability

there is. At the same time, too few members may not provide sufficient support or overall experience to carry out the body's responsibilities.

We recommend about a five-member governing body, which should make policy decisions regarding the allocation of the revenue authority's budget in addition to recruitment, transfer, evaluation, salaries, promotion, pension, and training of the employees working in tax administration. The responsibilities of the governing body are illustrated as follows:

- to ensure that the tax laws are enforced with the highest degree of integrity;
- to establish an overall pay and classification structure;
- to provide guidance and direction in resource allocation (making sure that resources are allocated properly among the various branches of the tax administration);
- to ensure that appropriate personnel and program management practices are in place and carried out. (This would include such things as training, personnel evaluations, and corrective actions to be taken, if any);
- to recommend to the government legislative changes needed to improve the administration of the tax laws;
- to establish an internal audit function staffed by professional auditors who would be responsible for determining if the policies of the governing body are being carried out properly. The governing body should approve the annual audit plan;
- to provide the Minister of Finance with revenue estimates on existing and proposed tax laws; and
- to establish and implement a written code of conduct for all employees in the revenue authority.

Scope of the Revenue Authority

It is recommended that various independent revenue departments should all be combined into one revenue authority under the supervision of the governing body. The integration of various departments will minimize both administrative and compliance costs. It will also be useful in harmonizing administrative policies and practices.

The revenue authority should also launch a comprehensive campaign to educate taxpayers and others about the nature, substance, and enforcement of various taxes. It should prepare working manuals, brochures, and pamphlets, and distribute them on a wide scale. It should also provide assistance to taxpayers in fulfilling their obligations.

Financing the Revenue Authority

There are different current practices for financing the revenue authorities. In Kenya, the Revenue Authority is given a certain percentage of the collected revenue, while in Singapore, Malaysia, and Jamaica, the revenue authorities are provided a lump sum amount as their budget. In Uganda, there is a provision for an automatic budgetary allocation, based on a performance contract between the Revenue Authority and the Treasury, but the Ministry of Finance currently allocates the budget.

In Bolivia and Jamaica, the financing of the revenue authority was initially high through budget allocations. Effective functioning of the revenue authorities in these countries, however, has been impeded by subsequent budget restrictions, which have been imposed on all government departments by the Ministers of Finance. This experience would suggest that a formula-based financing system is superior in ensuring that the effectiveness of the revenue authority is not affected at a time when it is most needed.¹³

In Nepal, since the Customs Department, the Land Revenue Department, the Tax Department, the Value Added Tax Department, the Revenue Investigation Department, and the Revenue Administration Training Centre are all involved in the administration, investigation, and training, it is necessary to calculate the expenditure of these departments in order to estimate the administrative costs of collection. The total cost of collection was 1.46 percent of the total tax collection in 1997/98.

The revenue authority should be financed on a formula basis, as a function of the revenues collected. It also should be given the authority to charge fees for other additional services it might be asked to provide. In addition, the revenue authority is usually entitled to borrow funds. A strict performance-based budgeting system should be implemented to monitor the performance of the tax

administration. With compensation based on the amount of revenues collected, there should be greater incentives, as seen in other countries, for the revenue authority to implement cost- effective practices in order to enhance taxpayer compliance.

In different countries, revenue authorities are required to produce annual financial reports. Moreover, in Kenya, Uganda, and Singapore, the Ministry of Finance is also authorized to demand reporting on a wide array of operations and performance related data. Public reporting of such data can both improve tax collection and act as a powerful force for ensuring the authority's fairness and political accountability.

Transition to the Revenue Authority

Transitional problems are inevitable. Issues to be expected include determining which employees should be retained on the basis of which criteria, where to assign those who will be let go (assuming they cannot be dismissed from the civil service), and so on. It will also take time to restructure the existing tax administration and to lay down the basic institutional foundations. Attempts, however, must be made to make a smooth transition, which will minimize costs. To this end, a committee should be created in order to consider the issues of job descriptions and specifications, hiring criteria and methods, job grading and compensation, staffing levels, training, performance evaluations, codes of conduct, and disciplinary and grievance handling procedures. It will be necessary to develop a sound corporate plan, performance standard, and a corporate culture in the revenue authority. The committee should also deal with the funding arrangement for the transition period. Establishment expenses are likely to be substantial. They should, however, lead to substantial revenue gains over time. Legislation must be drafted and enacted relating to the establishment of the revenue authority.¹⁴

Experience with the Revenue Authority

Tax administration reform has become an integral part of overall tax reform in many countries in recent years. In cases where budgetary and employment flexibility could not be achieved through the simple reform of civil service procedures, there has been a move to the organization of autonomous

revenue authorities. The autonomous revenue authorities have been created with the objective of creating an institutional mechanism for separating professionally competent staff members, who are willing to work for a competitive salary, from those who want to continue with the old system and seem to be incapable of making changes.

To date, countries that have set up autonomous revenue authorities include Jamaica (1981), Ghana (1985), Argentina (1988), Peru (1988), Colombia (1991), Spain (1991), Uganda (1991), Singapore (1992), Zambia (1993), Malaysia (1994), Kenya (1995), Bolivia, Mexico, and Venezuela. The trend for separation of the tax administration from the public administration is gaining momentum.

The results of the creation of revenue authorities around the world, to date, have been impressive. In countries where the revenue performance had been deteriorating badly, such as Argentina and Peru, revenues have increased by over ten percentage points of the GDP. In Uganda, the tax/GDP ratio increased from 4 percent preauthority period to about 10 percent in the postauthority period. In countries such as Spain and Singapore, which have the ability to pay competitive salaries and to purchase the capital equipment needed to modernize, the quality of the tax administration has been dramatically improved. In all cases, the level of taxpayer service and the professionalism of the staff of the tax administrations have been greatly enhanced.

Conclusion

The reform of tax administration has attracted much attention in the context of overall tax reform in the recent years. This is because mere formulation of a refined tax system, without successful implementation, is not an end in itself. Good tax policy cannot exist without good administration, particularly in low-income developing countries. Inefficient tax administration has been very costly to governments in terms of revenue losses, and to businesses in terms of compliance costs. The public perception of a tax administration's integrity, efficiency, and effectiveness directly affects the citizens' willingness to voluntarily comply with the tax laws.

It is necessary to provide the tax administration with a flexible structure that would allow it to fulfil its administrative and statutory obligations. To enhance the capacity of the administration to implement a modern tax system and to ensure the ability of the administration to hire, train, and retain competent and professional staff (accountants, lawyers, computer and information technologists, economists, statisticians, and managers) as well as to readily dismiss incompetent or dishonest officials, new organizational arrangements have to be considered that pay tax administrators wages that are close to market level. The structure of the new organization should be functional, and an adequate infrastructure should be supported to run the administration. It should be accompanied by a code of conduct with strong disciplinary measures. A revenue authority with responsibility for the administration of the tax laws, vested with financial and administrative independence, should serve as a catalyst for bringing about these reforms.

Notes

¹ Carlos A. Silvani and Alberto H. J. Radano. "Tax Administration Reform in Bolivia and Uruguay," in *Improving Tax Administration in Developing Countries*, edited by Milka Casanegra de Jantscher and Richard M. Bird. International Monetary Fund, Washington, D.C., 1992, p. 38.

² Robert Taliercio. "The Establishment and Demise of a Semi-Autonomous Tax Administration in Bolivia: Politics, Administration, and Performance, 1986-1997." An unpublished report, May 1999, p. 38.

³ Milka Casanegra de Jantscher and Richard M. Bird. "The Reform of Tax Administration," in *Improving Tax Administration in Developing Countries*, op. cit., p. 6.

⁴ Robert Taliercio, op. cit., p. 15 and 32.

⁵ Ibid., p. 90.

⁶ Ibid. p. 18.

⁷ Ibid. p. 20.

⁸ On the other hand, such rules sometimes prevent wrongdoing.

⁹ In Malaysia, the Minister of Finance appoints the Board, which has a Chairman, four members representing the government (one of whom shall be the Secretary General or Deputy Secretary-General to the Treasury, and not more than two others). See Inland Revenue Board of Malaysia Bill 1994, Section 6.

¹⁰ In Uganda, the Finance Minister appoints the Chairman. Commissioner General of the Authority, the Secretary of the Treasury, the Permanent Secretary (responsible for commerce), the Commissioner for Industry, the Governor of the Bank of Uganda, and four other members are appointed by the Ministry. See The Uganda Revenue Authority Statute, 1991, Section 5.

¹¹ The Zambia Revenue Authority Bill 1993, Section 10.

¹² The Inland Revenue Authority of Singapore Act 1992, Section 5.

¹³ Glenn P. Jenkins. "An Autonomous Revenue Authority for South Africa." An unpublished paper, April 27, 1995, p. 5.

¹⁴ For details, see Jeffrey M. Hall and Glenn P. Jenkins, "The Transition to a Revenue Authority." An unpublished paper, International Tax Program, Harvard University, April 27, 1995.